Initiating Coverage | 25 April 2016
Sector: Consumer

P&G Hygiene and Health Care

Large opportunity; high barriers to entry

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P&G Hygiene and Health Care

CMP: INR6,402 **TP: INR7,690 (+20%)** **Buy**

BSE Sensex	S&P CNX
25,838	7,899

Stock Info

Bloomberg	PG
Equity Sh (m)	32.5
52-Wk Range INR	6982 / 5171
1, 6, 12 Rel. Per (%)	-1/10/2
M.Cap. (INR b)	206.5
M.Cap. (USD b)	3.1
12M Avg Val (INR M)	51
Free float (%)	25.4

Financial Snapshot (INR Billion)

Y/E June	2016E	2017E	2018E
Sales	25.6	29.6	35.5
EBITDA	6.0	6.9	8.3
NP	4.2	4.6	5.6
EPS (INR)	128.9	142.6	171.0
EPS Gr.(%)	21.0	10.6	19.9
BV/Sh. (INR)	442.3	513.0	597.6
P/E (x)	49.7	44.9	37.4
P/BV (x)	14.5	12.5	10.7
EV/EBITDA	32.8	28.4	23.2
EV/Sales (x)	7.7	6.6	5.4
RoE (%)	31.4	29.9	30.8
RoCE (%)	31.8	30.2	31.1

Shareholding pattern (%)

	Dec-15	Sep-15	Dec-14
Promoter	70.6	70.6	70.6
DII	10.1	10.6	11.5
FII	3.3	2.5	2.0
Others	16.0	16.3	15.8

FII Includes depository receipts

P&G Hygiene and Health Care

Large opportunity; high barriers to entry

Please click here for Video Link

Large opportunity; high barriers to entry

Low penetration I Weak competition I Category development

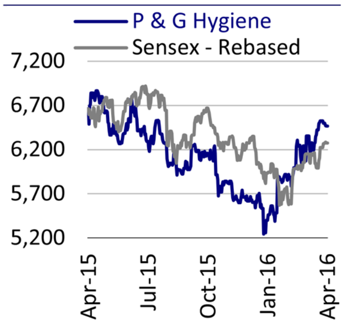
- **P&G Hygiene and Health Care (PGHH) should continue seeing strong volume growth in the Feminine Hygiene segment for several years, given low product penetration, greater affordability post price cuts, growing distribution reach, unmatched category development efforts and distinct competitive advantages. We expect steady growth in its other segments as well.**
- **Having hit a trough in FY13 due to price cuts, operating margin is expanding, led by healthy volume growth, selective price hikes and operating leverage. We expect healthy and sustainable EPS CAGR of 20% over the medium to long term, driven by strong revenue growth and operating leverage.**
- **We initiate coverage with a Buy rating and a target price of INR7,690.**

Volume growth in Feminine Hygiene segment to stay strong: Strong volume growth in the Feminine Hygiene segment (65% of FY16E sales) is being driven by a combination of (a) extremely low category penetration (~16%), with rural penetration in single-digits, (b) earlier price cuts boosting product affordability, (c) growing distribution reach, and (d) PGHH passing on the benefit of excise duty cut by the central government from 9% to 1% and VAT reduction by state governments to consumers. In the past few years, its *Whisper* brand has posted strong volume growth and its market share has risen to ~56%. Given the abysmally low penetration, we expect several years of strong volume growth in what is an essential product for a large segment of the population.

Far ahead of competition: Johnson & Johnson (*Stayfree* and *Carefree* brands; ~28% market share) does not have PGHH's dedicated focus (J&J's Feminine Hygiene segment accounts for only ~16% of its total India revenue against 65% for PGHH) or distribution reach. Kimberly Clarke (*Kotex* brand), the erstwhile third-largest player, has reduced focus on this business in recent years. A recent entrant, Japanese company Unicharm (*Sofy* brand) has gained less than 2% market share and has limited distribution reach. All the large global players are already present in India and there is no significant local player. Worldwide, private labels have had low success in this category. Due to its advantages over peers, PGHH could gain much higher share in a rapidly growing market (not factored into our forecasts until FY18, up to which we are assuming growth in line with market).

Further increase in distribution reach to raise entry barriers: PGHH's products across its categories reach only 1.3m-2m outlets in India, a fraction of its parent's reach of 6m-6.2m outlets in the country. While its reach has expanded significantly in the last few years, there is still considerable growth potential, given the increased product affordability. With low priced units in both Feminine Hygiene and Healthcare, PGHH is well placed from an SKU perspective. Currently, the rural

Stock Performance (1-year)



markets account for just ~20% of its Feminine Hygiene product sales. This should increase, as the product is now highly affordable.

Unmatched category development efforts: PGHH has had a significant head start with its unparalleled category development efforts in schools and villages. Only Colgate-Palmolive (India) in the oral care segment surpasses PGHH's category development efforts in the entire consumer sector. For the past few years, PGHH has been running a program called *Parivartan* in schools across India, educating menstruating schoolgirls about the need for better hygiene. Through its disproportionate focus on the 'point of market-entry customer', it has reached 4m-5m schoolgirls each year in 15,000 schools across the country in the each of the past three years including FY15 (June year-end). In a category where overall penetration is around 16% and rural penetration is in single digits, the benefits of such efforts are massive.

Initiating coverage with Buy: PGHH's current P/E multiples are in line with other Consumer MNCs, despite its distinct advantages over peers – (1) it is in a much faster growing category, and (2) it enjoys far superior barriers to entry in its key Feminine Hygiene segment. Its ongoing distribution expansion and unmatched category development efforts will only enhance the entry barriers. PGHH could compound its revenue manifold by gaining share in an ever increasing pie. Its earnings growth prospects are superior to peers. We expect ~20% EPS CAGR over the medium to long term. PGHHHH's balance sheet is healthy, with negative working capital and RoE of over 30% and RoIC of over 100%. These metrics call for a significant premium to peer valuations. We assign a target multiple of 45x FY18E EPS – 10% premium to the average one-year forward multiple of the last three years. This results in a target price of INR7,690 – 20% upside.

Several years of strong growth ahead

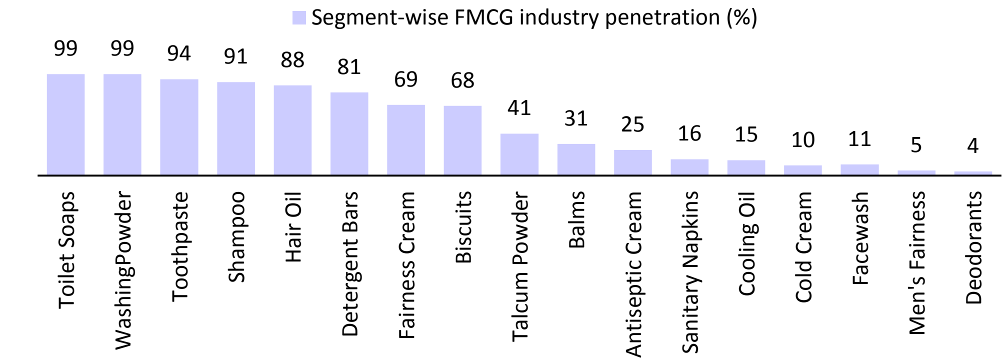
Feminine Hygiene the key driver

- **Low penetration presents huge growth opportunity**
- **Earlier price cuts have boosted affordability**
- **Potential increase in distribution through P&G Home Products' reach**
- **Unique category development efforts**
- **Weak competition**

Penetration low; huge growth opportunity in Feminine Hygiene

Feminine Hygiene is among the most under-penetrated segments in the Consumer space. According to market research firm, AC Nielsen's data, Feminine Hygiene market penetration was only 11% in 2011. While product affordability was an issue earlier, this is no longer the case, with the price per pad declining sharply over the past few years. Despite strong volume growth in the past few years, penetration is low at ~16%. This is much lower than other emerging markets like China and Thailand (50-60%), Indonesia (over 80%) and Kenya (~30%), and in line with Uganda and Tanzania (~16% each). In developed countries like the US, UK and Germany, the penetration levels are 90-95%.

Exhibit 1: Feminine Hygiene penetration in India is at extremely low levels



Source: Nielsen, Company, MOSL

Such low levels of penetration are usually witnessed in categories that are relatively discretionary in nature and not in a category like sanitary napkins, which are essential to a large segment of the population.

We can also arrive at a 16.2% penetration level through the following exercise, starting from Central Statistical Organization (CSO) data on female population in India in the age group of 15-45 years.

Exhibit 2: Feminine Hygiene market penetration calculation

Market penetration calculation	
Available market size for category (m)	310
Population above poverty line (m)	186
Total pad requirement in one cycle	11
Average total cycles in a year	13
Average cost of one pad (INR)	7
Costs incurred per year (INR)	1001
Total market potential (INR m)	**186,186**
PGHH's segmental sales in FY16E (INR m)	16,890
PGHH's market share (%)	56%
Current market size (INR m)	**30,161**
Market penetration (%)	16.2%

Source: CSO, MOSL

Penetration even in urban areas is below 30% and is likely to be in low single digits in rural areas.

We have looked only at the penetration data in the report so far. In terms of per capita consumption too, India ranks very low. In fact, in the entire Eastern Europe, Middle East and Africa and South Asia region, only Pakistan has lower per capita consumption according to P&G's own data. Among other BRIC nations, the per capita consumption is 25x higher in Russia and 10x higher in South Africa.

With higher product affordability, rising distribution reach of incumbents, increasing education and income levels among females, rapid urbanization, rising proportion of working women, higher product awareness through media, breaking of taboos and category development efforts by companies like PGHH, usage is picking up in what is an essential product for a large segment of the population. Given the low penetration, we expect strong volume growth to continue for several years. The confluence of company initiatives and favourable social factors should drive rapid growth in the category.

Affordability increasing with price cuts, driving volume growth

Over FY09-11, PGHH, already a market leader in the segment, decided to cut product prices unilaterally to boost affordability, a move followed by its competitors. Price cuts of 25-40% across categories resulted in strong volume growth since then. The central government cut excise duty on the product from 9% to 1% over the period, and in FY12, various state governments reduced VAT on the product from 14-15% to 4%-5%. PGHH passed on the benefits to consumers, further boosting affordability.

Volume growth in the Feminine Hygiene segment has averaged at ~ 15% YoY for the past 20 quarters. Given that market penetration can continue to grow at a rapid pace for many years to come, we continue to expect ~15% volume growth for the next few years. Very few categories in the Indian Consumer sector are witnessing such strong volume growth.

Exhibit 3: Average volume growth…

Companies	20-quarter average volume growth (%)
Asian Paints	9.9
Colgate (Toothpaste)	9.0
Dabur	8.8
Godrej Consumer – Soaps	7.8
GSK Consumer	6.1
Hindustan Unilever	6.6
ITC (cigarette)	-2.4
Marico – Parachute	7.7
Marico - Hair Oil	17.1
Marico – Saffola	8.4
PGHH - Feminine Hygiene	~15.0

Source: Company, MOSL

Exhibit 4: …and average revenue growth significantly ahead of peers

Consumer	20-quarter average sales growth (%)
Asian Paints	14.6
Colgate	13.6
Dabur	17.0
Godrej Consumer	24.7
GSK Consumer	14.1
Hind. Unilever	10.7
ITC	12.1
Marico	15.5
PGHH	21.7

Source: Company, MOSL

Exhibit 5: VAT rates on sanitary napkins

State	VAT rate (%)
Maharashtra	5
Tamil Nadu	5
Goa	0
Madhya Pradesh	5
Gujarat	5
Orissa	5

Source: Media, MOSL

Widening distribution reach

Increased affordability has broadened the potential reach of PGHH's products in the Feminine Hygiene segment. While distribution of PGHH's products has improved in the last few years, also aided by price cuts in Feminine Hygiene, there is plenty of scope for further expansion. *Vicks Cough Drops* reaches 2m outlets, *Vicks Vaporub* around 1.2m outlets and *Whisper* reaches around 1.3m outlets. This is only a fraction of P&G Home Products' existing reach in India, which at over 6m outlets (direct reach: 1.5m outlets; balance through distributors), is only marginally lower than the largest player in the Indian Consumer sector, Hindustan Unilever, which reaches ~7m outlets. Even if PGHH has to pay distribution commission to the unlisted P&G Home Products for access to these 6m+ outlets, it would be worth it because of the phenomenal growth opportunity. With low-priced units in both Feminine Hygiene and *Vicks*, PGHH is well placed on the SKU front. Currently, rural markets account for ~20% of its Feminine Hygiene sales, which should increase, as the product is now highly affordable and is an essential requirement for a large part of the population.

P&G's policy in India in terms of cost sharing across its companies is transparent:

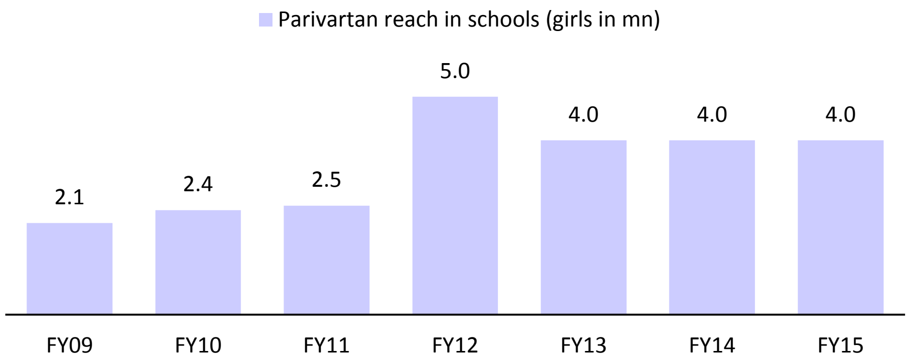
- Costs on distribution are shared across all entities since the sales force is common. Costs are allocated according to sales.
- All direct costs like materials are charged to the respective entity.
- Some employee costs are shared, as resources are shared. All cost allocations are based on sales.
- As a group, the companies get better rates for marketing spends and for joint material procurements. Some R&D costs are also shared

Unmatched category development efforts

Its category development efforts set PGHH apart from its peers in the Feminine Hygiene segment. In the Consumer sector, only Colgate-Palmolive (India) in the oral care segment surpasses PGHH's efforts in growing the Feminine Hygiene category. For the past few years, PGHH has been running a program called *Parivartan* in schools across India, educating menstruating schoolgirls about the need for better hygiene. The program also involves distribution of free sanitary pads.

Through its disproportionate focus on the 'point of market-entry customer', it has reached 4m-5m schoolgirls each year in 15,000 schools across the country in the each of the past three years including FY15 (June year-end). In a category where overall penetration is around 16% and rural penetration is in single digits, the benefits of such efforts are massive. Focus on 'point of entry customer' is very high, not only in India but also globally, partly because P&G believes that loyalty to the first Feminine Hygiene product that a female uses is fairly high.

Exhibit 6: 'Parivartan' – Increasing barriers to entry



Source: Company, MOSL

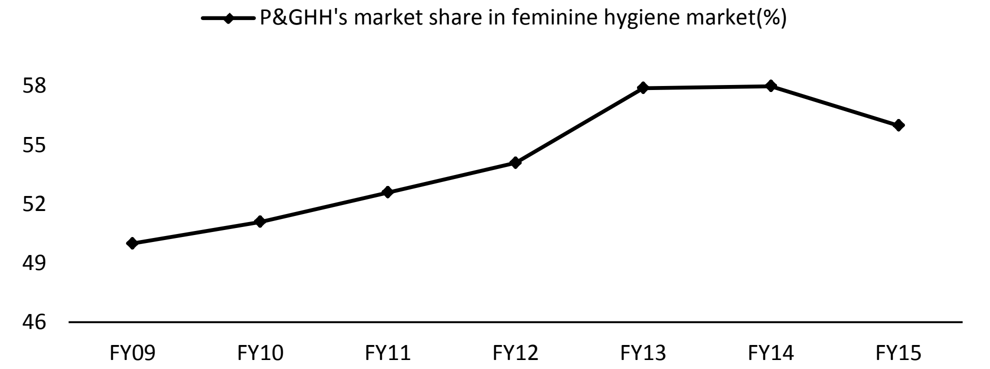
Apart from the obvious benefits from higher product affordability after price cuts, improvement in education and income levels, rapid urbanization, rising proportion of working women and higher product awareness, the management rightly felt that spreading product awareness would grow the Feminine Hygiene segment significantly, especially considering the backdrop of paltry market penetration in what is an essential product for a large segment of the population.

The 'point of entry customer' focus (extensive program in schools and villages for developing the Feminine Hygiene category) would continue. In fact, it could pick up further, despite increasing global focus on both revenue and profitability. PGHH uses smaller size packs of its premium and mid-tier products as part of this program, and not its lower priced products. We note that none of its peers has a category development program.

Leader in Feminine Hygiene segment; far ahead of competition

PGHH's market share in the Feminine Hygiene segment (all its feminine hygiene products are under *Whisper* brand) has grown from 50% in FY09 to over 56% in FY15. While competitors followed PGHH's price cuts, they do not have the combination of its strengths – distribution reach, dedicated focus, category development efforts, backing and product portfolio from the largest Feminine Hygiene company in the world (P&G), and financial muscle. We believe PGHH can not only grow the category, but also continue to gain market share from weaker peers. Thus, PGHH could have a much higher share of a rapidly growing pie.

Exhibit 7: PGHH has reported strong growth in Feminine Hygiene market share



Source: Company, MOSL

Taking a look at some of PGHH's competitors in Feminine Hygiene

Johnson and Johnson (J&J) is currently the second-largest player in the Feminine Hygiene market, with ~28% market share through its *Stayfree* and *Carefree* brands. J&J has lost further market share since the price cuts. Feminine Hygiene products account for only 16% of its total sales in India in FY14 (last available data, J&J India is an unlisted company). Its main focus is on pharmaceutical products and baby products. Over the long run, J&J's market share losses in the Feminine Hygiene segment have been even steeper. Before PGHH launched *Whisper* in 1989, J&J was the dominant market leader in the Feminine Hygiene segment.

Exhibit 8: PGHH consistently beating J&J in Feminine Hygiene business

INR m	FY09	FY10	FY11	FY12	FY13	FY14
P&G Sanitary products sales (June year-end)	4,279	5,324	6,235	8,122	10,883	13,462
Growth (%)		24.4	17.1	30.3	34.0	23.7
Johnson and Johnson sanitary sales (adjusted)	3,150	3,787	3,907	4,860	5,476	6,723
Growth (%)		20.2	3.2	24.4	12.7	22.8
J&J sanitary napkin sales as proportion of P&G (%)	73.6	71.1	62.7	59.8	50.3	49.9

Source: Company, MOSL

Over the last five years, J&J India's Feminine Hygiene business has consistently underperformed PGHH's. As a percentage of PGHH's Feminine Hygiene sales, J&J's Feminine Hygiene sales have declined from ~74% in FY09 to ~50% in FY14. Its market share is believed to be ~28% as at the end of FY14, half of PG's market share. This also means that the entire portion of PGHH's incremental market share gain in the past few years has been at the cost of J&J. Nevertheless, the market remains a duopoly, with the two larger players accounting for ~84% of the market. There is no marked difference in the average product prices of PGHH and J&J India.

In a deal concluded in November 2013, J&J India's parent sold *Stayfree* and *Carefree* tampon brands in the US, Canada and the Caribbean to Energizer Holdings in an all-cash deal worth USD185m. Energizer had a small presence in the global Feminine Hygiene segment, with 4% of its sales coming from its own brand, *Playtex*. Whether the India business will also be sold subsequently, remains to be seen. J&J India's website continues to list *Stayfree* as one of its brands in the consumer space and the product packaging continues to mention it as a J&J product. Energizer does not have a distribution presence in India and if any such deal happens, it may have to depend on J&J or find a new partner for distribution. It could also go with Eveready Industries India (EVRIN), formerly Union Carbide (India), and a part of the BM Khaitan Group. EVRIN is a licensee of the *Eveready* brand of batteries in India, Bhutan and Nepal. Energizer owns the *Eveready* brand globally. While EVRIN has access to over 3.2m outlets, it has no experience in selling healthcare products.

Kimberly Clarke Lever, the erstwhile third-largest player, with 4.5% market share in 2008, has seen its market share declining to negligible levels. It is no longer focused on the Feminine Hygiene segment (brand: *Kotex*), preferring instead to concentrate on its baby diaper brand *Huggies*, which has lost substantial market share to P&G Home Products' *Pampers*. Kimberly Clarke Lever is a joint venture (JV) in India between Kimberly Clarke USA, a large player in the global consumer and Feminine Hygiene market, and Hindustan Unilever (HUVR). Despite access to HUVR's distribution reach, *Kotex* never really made a big dent in the Feminine Hygiene segment. The financials of the JV (part of HUVR's annual report) indicate poor growth and EBITDA losses.

Exhibit 9: Financials of Kimberly Clarke Lever India

INR m	FY11	FY12	FY13
Net sales	1,024	1,204	1,157
Growth (%)	-	17.6	-4
Operating expenses	1,152	1,274	1,327
EBITDA	-128	-70	-170
EBITDA margin (%)	-12.5	-5.8	-14.7

Source: Company, MOSL

HUVR has stopped giving detailed financials of the Kimberly Clarke Lever JV in the last two years in its annual report, but there has been severe market share erosion even in the case of *Huggies* over the past two years. Net losses continued to be a feature of this JV with INR98m loss even in FY15.

Smaller players in the market include Japanese company, Unicharm, which launched its *Sofy* brand of sanitary napkins in India in 2011. It is the only player to gain market share (albeit off a zero base) apart from PGHH in the past few years. Unicharm seems to have grabbed a part of the market vacated by Kimberly Clarke Lever. *Sofy* is a successful brand in other parts of Asia, but its geographical presence in India is limited. Unicharm also makes the *Mamy Poko* brand of diapers, launched in India in 2009. It has two plants at Majrakath (Neemrana) in Rajasthan and Sri City in Andhra Pradesh. The company's average product prices are also at a discount compared to the larger players, PGHH and J&J.

Unicharm's *Mamy Poko* has been a huge success. *Sofy*, while successful, still has less than 2% market share according to our analysis of Unicharm India's published segmental data. Through *Mamy Poko*, Unicharm introduced a disruptive product – pant style diapers – in the baby diaper segment. However, it hasn't been able to bring in a breakthrough product in the Feminine Hygiene space and price discount has not been a significant help. Despite leveraging on the reasonable distribution reach created by piggybacking on the distribution reach of *Mamy Poko*, *Sofy* (or its newer feminine hygiene brand, *Lifree*) haven't made much headway. Nevertheless, from a competitive standpoint, we believe Unicharm remains the player to watch out for.

Exhibit 10: Unicharm's Feminine Hygiene sales are only a fraction of PGHH's

INR m	FY14	FY15	Growth (%)
Unicharm, Total Net Sales as per P&L (including diapers)	4,519	8,438	87
Unicharm, Total Gross Sales as per P&L (including diapers)	5,077	9,369	85
Sofy	245	489	100
Lifree	-	8	
Total Feminine Hygiene sales – Unicharm	**245**	**497**	**103**
PGHH Feminine Hygiene sales	13,462	15,327	14
Unicharm India/ P&G Feminine Hygiene (%)	1.8	3.2	
If PGHH is 56% market share,			
then Unicharm India's market share is (%)	1.1	1.8	

Source: Company, MOSL

The other significant global player, Swedish company SCA Hygiene (brand: *Libresse*) recently re-entered India on its own after an unsuccessful JV with Godrej Consumer Products. SCA also sells its other global brands like *Tempo* and *Tork* through the import route. *Tempo* is the world's largest consumer tissue brand and *Tork* is a hand sanitizer brand. Media reports indicate that its distribution reach is less than 100,000 outlets. SCA set up a manufacturing facility at Ranjangaon near Pune in 2015 for both its diaper brand *Libero* and tissue brand *Tempo* at a capex of INR5b over five years. Gradually, it will also begin manufacturing *Libresse* and *Tork* locally. With SCA Hygiene's re-entry, all the large global players have their presence in India.

Besides the large MNC players, a smaller global player, Bella Hygiene has a token presence in India. Bella (earlier a JV between TZMO of Poland and Premier of India; now a wholly owned subsidiary of TZMO) is present in select markets like Pune.

Exhibit 11: Price points of sanitary pads in India

Category	Number of pads	Price (INR)	Price per pad (INR)
Basic			
PGHH - Whisper choice/regular	8	34	4.25
J&J - Carefree super dry, Stayfree secure/XL wings/dry	7-20	34-70	3.5-4.8
Unicharm - Sofy body fit/XL	45	345	7.67
Emami - She comfort select	8-20	30-70	3.5-3.75
Intermediate			
PGHH - Whisper maxi clean/fit/regular	8-15	77-138	9.2-9.625
J&J - Stayfree dry max/all night/with wings	7-28	85-315	11.3-12.1
Unicharm - side walls large/XL	6-28	45-198	7.1-7.5
Advanced			
PGHH - Whisper ultra clean/with wings/Xl	15-30	159-310	10.3-10.6
J&J - Stayfree advanced/ultra-thin	7-14	78-135	9.6-11.2
Emami- She comfort ultra with wings/Xl	6-15	40-90	6-6.7

Source: MOSL

Smaller players, store brands have no significant presence

Apart from the MNC brands stated above, there are small local brands in the Feminine Hygiene market – *She Comfort* (Emami; earlier owned by Royal Hygiene), *Shapers* (Gufic Biosciences), *Don't Worry* (Mankind Pharma) and *Wow* (Future Retail). None of these has been able to make its presence felt. Feminine Hygiene is a difficult market to penetrate, given the personal touch and trust factor involved.

Unlike most other consumer categories in India, there is no unorganized segment. Users move from traditional products like cloth directly to the organized segment, dominated by the MNCs. PGHH enjoys the highest market share and the most favorable barriers to entry versus existing and potential competition.

Interestingly, Feminine Hygiene is also a category where private labels have not been successful globally or in India. Even Wal-Mart does not have a competing product. It is a category where brand equity and assurance of quality counts for a lot and private labels have a reputation of being 'cheap'.

Increasing salience in P&G's global scheme

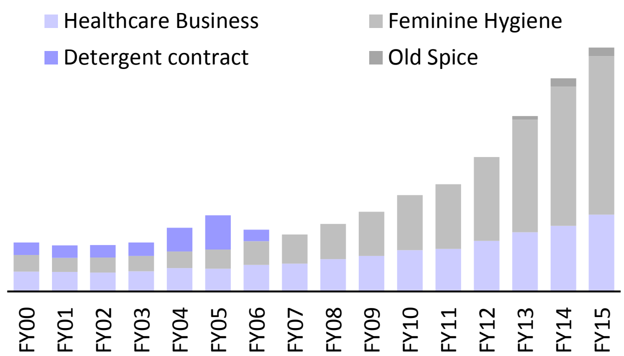
In a restructuring exercise last year, feminine care (accounting for ~6% of P&G's global sales) is now clubbed together with baby care, feminine care and family care instead of being part of the Healthcare segment. This is expected to result in greater focus and innovation in this segment, where P&G is also the global market leader. While the share of revenue from India on an overall basis (including unlisted P&G Home Products and listed entities, PGHH and Gillette India) is only around 2.1%, the Feminine Hygiene segment in India is more relevant and increasing in salience on a global basis, more than doubling from 2.6% of global Feminine Hygiene sales in FY10 to 5.3% in FY15 (both June year-end).

Exhibit 12: PGHH - rising salience of Feminine Hygiene segment in global sales

	FY10	FY11	FY12	FY13	FY14	FY15
USD INR rate	46.5	44.7	55.5	60.2	60.1	63.5
India sales In USD m	835	1,095	1,159	1,319	1,529	1,629
Global sales USD m	**73,435**	**76,982**	**79,545**	**80,116**	**80,510**	**76,279**
India sales to global sales	1.1%	1.4%	1.5%	1.6%	1.9%	2.1%
Global feminine care proportion	6%	6%	6%	6%	6%	6%
Global feminine care sales USD m	4,406	4,619	4,773	4,807	4,831	4,577
PGHH feminine care INR m	5,324	6,235	8,122	10,883	13,462	15,327
PGHH feminine care USD m	115	140	146	181	224	241
PGHH Feminine care to global	2.6%	3.0%	3.1%	3.8%	4.6%	5.3%

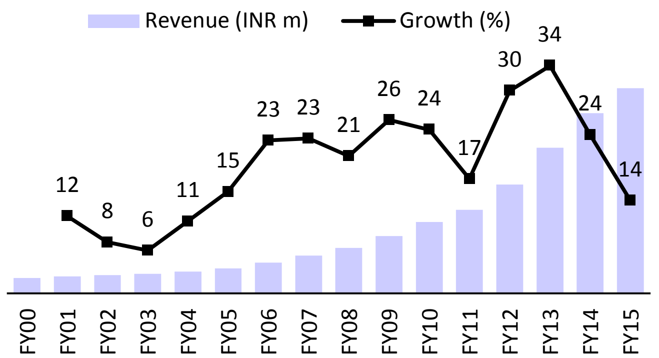
Source: Company, MOSL

Exhibit 13: Segment-wise revenue (INR m)



Source: Company, MOSL

Exhibit 14: Feminine Hygiene segment's revenue growth



Source: Company, MOSL

The movement of the global feminine care segment last year from the Healthcare head to a new head – Feminine, Family and Baby Care – enables synergies, alignment with competitors on product profile and development of categories like adult incontinence within this segment using a combination of feminine and baby care segment technologies. These new products globally are also likely to be a part of PGHH's portfolio in India.

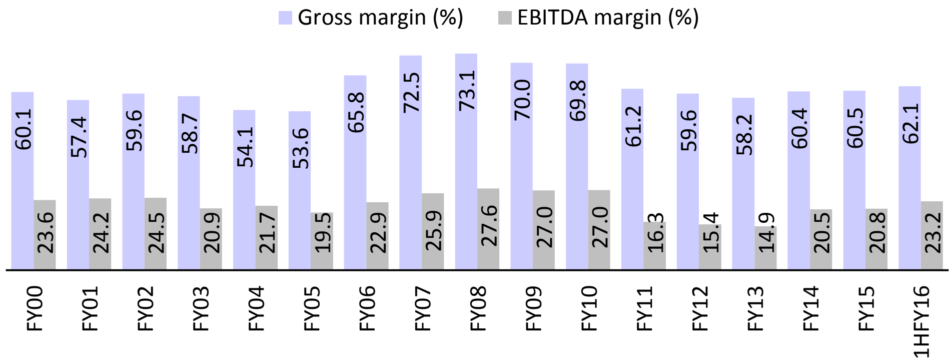
Willingness to go for selective price hikes in Feminine Hygiene segment

After the voluntary price cuts and passing on of excise duty and VAT reduction benefits to consumers, PGHH restrained itself until FY14 from hiking product prices even when raw material costs went up. As a result, margins were under pressure.

Over the last three years, however, PGHH has hiked prices as and when required, being fairly confident about its volume growth and strengths over competitors.

Gross margin has come off a trough in FY13. In the longer term, there is huge scope for premiumization, as consumers trade up to thinner and 'all night' products. For now, however, gross margin may have neared its medium-term peak at 62.4% in 2QFY16. Feminine Hygiene features strong brand loyalty in India and worldwide. Consumers usually trade up and rarely trade down. However, given the extremely low penetration, growth is unlikely to come from the premium end of the market.

Exhibit 15: After price cuts earlier, margins improving in the last few years

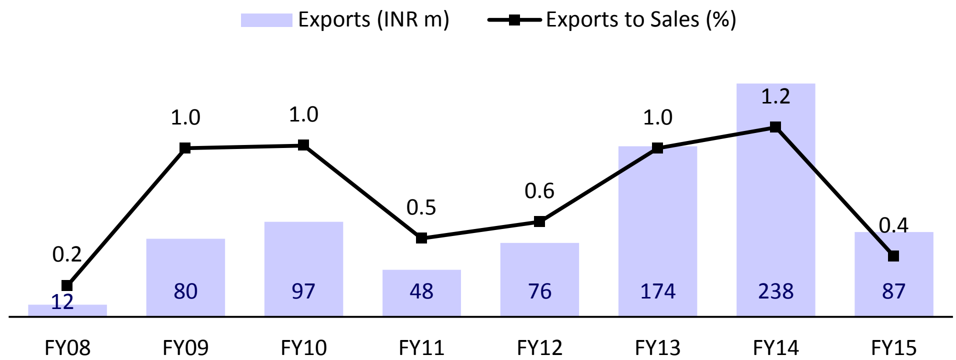


Source: Company, MOSL

Exports – a longer term opportunity

P&G's Feminine Hygiene market share is ~50% in the US and Western Europe. In Central and Eastern Europe, Middle East and Africa, it is ~46%, but is lower in Latin America at 24% and Asia at 13% (despite high market share in India). This is due to its fairly recent entry and lack of presence across all segments in these two geographies. However, the last two geographies are expected to be growth drivers for the global Feminine Hygiene segment. The company concurs that exports from India could rise due to geographical proximity to other Asian markets. Exports from India are very small as a percentage of PGHH's sales. There is no significant difference in the cost structure, but geographical proximity does help.

Exhibit 16: Exports currently a miniscule proportion of PGHH's sales



Source: Company, MOSL

Healthcare and Old Spice – steady growth

In FY16, we expect the Feminine Hygiene segment to contribute 65% of sales and the Healthcare segment (*Vicks*) to contribute ~31% of sales. The remaining ~4% contribution would come from *Old Spice* (aftershave lotion / deodorants).

Healthcare segment

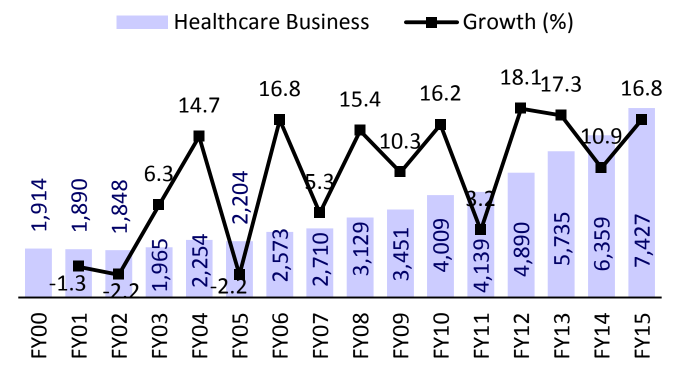
All products in this segment are sold under the *Vicks* brand and include *Vicks Vaporub* balms, *Vicks Cough Drops*, *Vicks Inhaler* and *Vicks Action 500* tablets. PGHH is the market leader in the cough, cold and hay fever segment of OTC products, with over 30% market share.

In FY15, PGHH's market share in the Healthcare segment in India was its highest ever. Growth has picked up compared to preceding years in the last year. Renewed advertising efforts in case of *Vicks* in early FY15 with Virat Kohli as the brand ambassador seems to have paid off. The management attributes the recent strong growth to 'product initiatives and investment behind proven equity advertising'. Its key brand extension in this segment – *Vicks Vaporub* – had a record year in FY15 and attained its highest ever market share. *Vicks* continues to be India's leading Healthcare brand according to the management. FY15 also saw the launch of *Vicks MultiPain Relief Gel*.

Categories like pain gel are large globally, contributing ~25% of *Vicks'* sales. *Vicks* is a large brand for the parent and reached sales of USD1b two years ago. Sleep aids is another category that was launched three years ago by the parent; these are sold only in USA and Canada currently, and account for ~10% of *Vicks* sales.

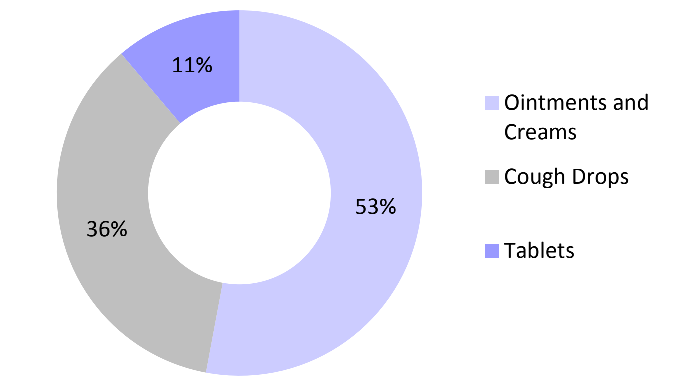
New products under P&G's global OTC JV with Teva like vitamins and mineral supplements could potentially form part of the Healthcare segment in PGHH. These are from the acquisition of New Chapter Vitamins by P&G in North America a few years ago.

Exhibit 17: Healthcare segment growth



Source: Company, MOSL

Exhibit 18: Healthcare product-wise breakdown - FY15



Source: Company, MOSL

Vicks Vaporub accounts for over 53% of segment's revenue and *Vicks Cough Drops* contributes around 36%, while the other two products (mainly tablets, and to a lesser extent, inhalers) account for the rest. Of the overall revenues, Vicks Vaporub and Vicks cough drops are ~17% and 11% of revenues respectively.

In Healthcare, part of the sales growth in FY15 may have been weather-related, mainly because of the severity of the winter and unseasonal rains. A high base in one year can result in lower growth in the subsequent year, as is proving to be the case in 1HFY16.

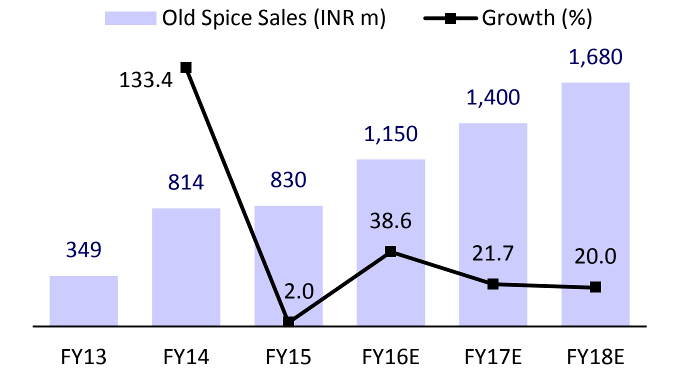
Competitors in this segment vary across products like *Vicks Vaporub*, *Vicks Inhaler*, *Vicks Cough Drops* and *Vicks Action 500*, and include Reckitt Benckiser (which owns the erstwhile Paras Pharma business), Amrutanjan, Dabur, Emami, Mondelez-Cadbury, Ricola and all the leading domestic and OTC pharma companies that have the products to cater to this segment.

Old Spice range of products

Until March 2013, PGHH had out-licensed the manufacture of *Old Spice* range of aftershave products to a third party. Hence, this business did not reflect in its sales, but as part of licensing income. After termination of the agreement with the third party, sales of *Old Spice* products returned to PG's books from March 2013. During the out-licensing phase, *Old Spice* was focused on aftershave products. PGHH has recently entered the fast-growing deodorants category to leverage its brand equity and distribution reach.

For the parent, *Old Spice* is present across categories like body wash, deodorants and body spray, apart from aftershave lotions. Besides *Gillette*, *Old Spice* is P&G's key men's grooming brand globally, and should be an important growth area in India as well. Yet, given its small contribution to overall revenue and continued healthy growth in the two larger segments, we expect the share of *Old Spice* in overall sales to remain low.

Exhibit 19: Old Spice sales trend



Source: Company, MOSL

Exhibit 20: Old Spice aftershave and deodorants

Source: Company, MOSL

SWOT Analysis

- With trust an important factor, the reputation that *Whisper* and *Vicks* enjoy is an entry barrier.
- **PGHH has the wi**dest portfolio among peers; the support of its parent aids further portfolio expansion.
- PGHH is reaching 4m-5m school girls every year through its extensive category development program.
- Feminine Hygiene accounts for 2/3rd of PG's sales, much higher thah peers like J&J, Unicharm, Kimberly Clarke and Emami.

S

- While the different P&G entities in India are in mutually exclusive segments, it also means that new product categories will go to the unlisted entity (P&G Home Products).
- If PGHH is unable to execute on the growth opportunity in Feminine Hygiene, its high dependence (65% of sales) on this segment will be a drag.

W

- Penetration of only 16% in the key Feminine Hygiene category is a massive opportunity,
- PGHH reaches 1.3m-2m outlets across its segments. P&G Home products reaches over 6m outlets,.
- PGHH could get products in the Cough, Cold and Hay Fever segment from the global P&G-Teva OTC JV.
- PGHH could be P&G's exports hub for the Feminine Hygiene segment across Asia, given low existing market share in the region.

O

- PGHH's products bank heavily on the trust factor. Any product quality incident could have severe ramifications.
- PGHH is not present/strong at the lowest commoditized end of the Feminine Hygiene market. Starkly higher growth in this sub-segment compared to other sub-segments could have a detrimental impact on market share.

T

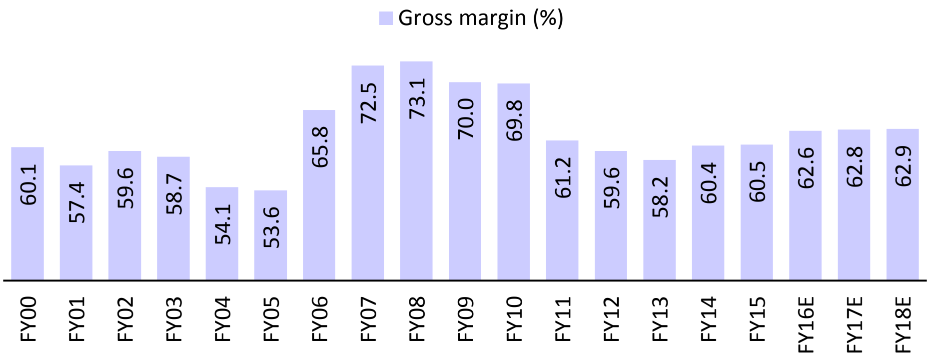
Operating leverage to improve profitability

Other expenses to decline as a proportion of sales

- **Highly profitable category; Gross margins better then peers**
- **Impact of price cuts on margins and subsequent recovery**

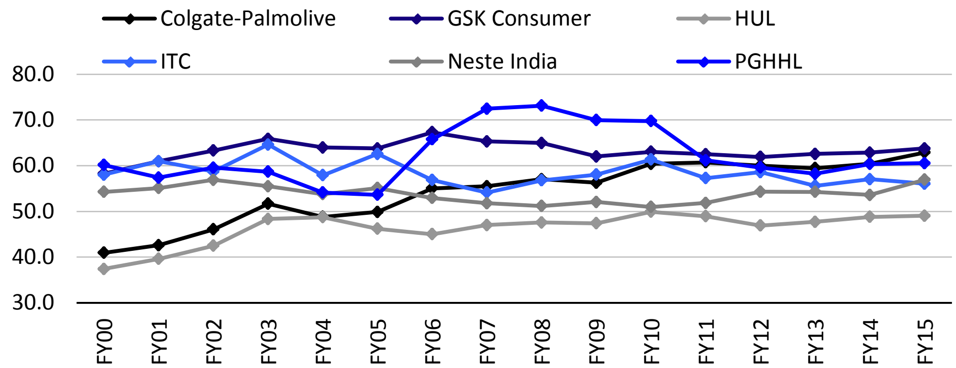
High gross margins indicate high profitability: In the period FY09-FY11, the company had cut product prices in the feminine hygiene segment by 25-45% in an effort which successfully boosted volume growth.
Despite the price cuts, PGHH's gross margin is among the highest in the Consumer space, indicating high pricing power.

Exhibit 21: Gross margin for FY15 was 60.5%



Source: Company, MOSL

Exhibit 22: Gross margin comparison with peers



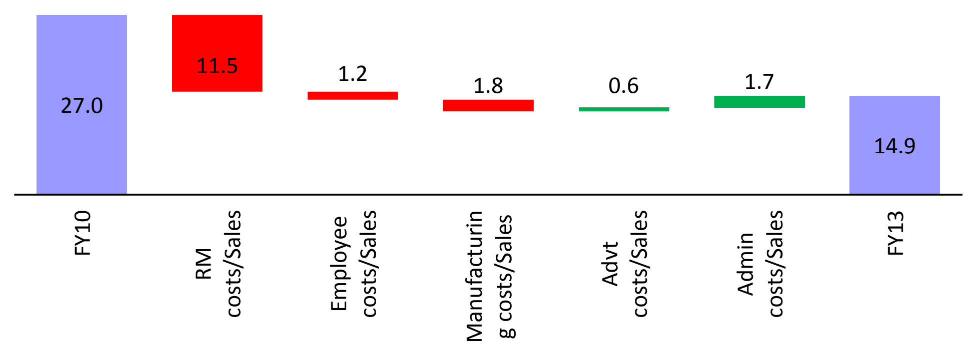
Source: Company, MOSL

Impact of price cuts on margins, recovery and potential further rise in margins in the long term

Phase of decline in margins (FY10-FY13)

In response to the price cuts, volumes soared, but revenue growth was impacted, as realizations declined steeply. Sales grew 19.4% in FY10 and 8.5% in FY11, despite volume growth of 28% and 31%, respectively in the Feminine Hygiene segment. Following the price cuts, overall gross margin declined and staff and other costs increased. Between FY10 and FY13, as a percentage of sales, raw material cost increased 1,150bp and staff cost rose 120bp. The big collapse in EBITDA margin was in FY11, when it slipped from 27% to 16.3%, while absolute EBITDA declined 34.4%. Since then, the dip in EBITDA margin was more gradual, down to 14.9% in FY13. Interestingly, while advertisement spending grew sharply for most of the years, on an absolute basis, it was outpaced by sales growth in this period. Hence, the advertisement spending to sales ratio declined.

Exhibit 23: Impact of price cuts on EBITDA margin over FY10-13

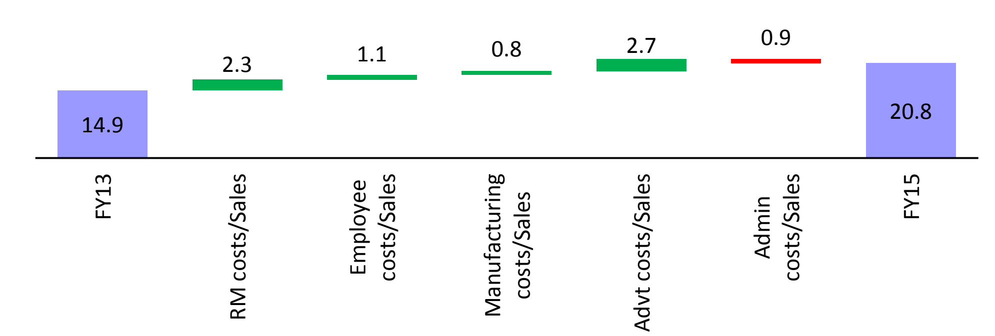


Source: Company, MOSL

Phase of recovery in margins (FY13-FY15)

After a trough in FY13, EBITDA margin expanded 490bp over the next two years to 20.8%. This was led by healthy volume growth and selective price increases, unlike the earlier period when prices were cut and then maintained. Margin expansion was also aided by soft material costs, operating leverage on healthy sales growth, and lower than average A&P to sales over this period. Admin expenses to sales, however, increased during this period.

Exhibit 24: Volume growth + Cost savings = Margin improvement over FY13-15



Source: Company, MOSL

The next phase (FY15-FY18E), operating leverage kicks in

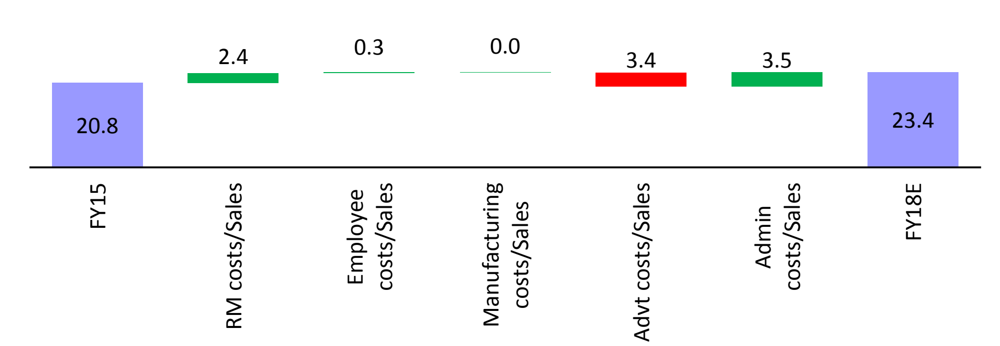
Gross margin has improved considerably in 1HFY16, following moderation in costs of packaging, cellulose, cotton, wax and chemicals. Gross margin expanded 250bp YoY to 62.4% in 2QFY16 and 300bp YoY to 62.1% in 1HFY16. We estimate gross margin at 62.6% for the full year and a steady increase up to 62.9% by FY18 from 60.5% in FY15. Over the long term, with premiumization of the Feminine Hygiene segment, gross margin could move up sharply. However, for the next few years, the mid-tier segment would drive growth. Hence, we do not expect a big spurt in the near term.

As a percentage of sales, staff costs have risen in YTDFY16. However, with revival in sales growth momentum in subsequent years, we expect the staff cost to sales ratio to decline by 30bp over FY15-18 to 4.6%.

A&P to sales has declined in the current year as is the case for FMCG peers. For 1HFY16, A&P to sales was 12.7%. We expect higher A&P in 2HFY16, leading to full year A&P to sales of 16%. The ratio should improve further to 17.6% in FY17 and to 17.7% in FY18, in line with the average for earlier years. Even A&P to sales of ~15% is one of the highest among Consumer peers.

We expect 350bp decline in other expenses to sales over FY15-18 to 15.6%.

Exhibit 25: Benign material costs and Operating cost to drive further profitability



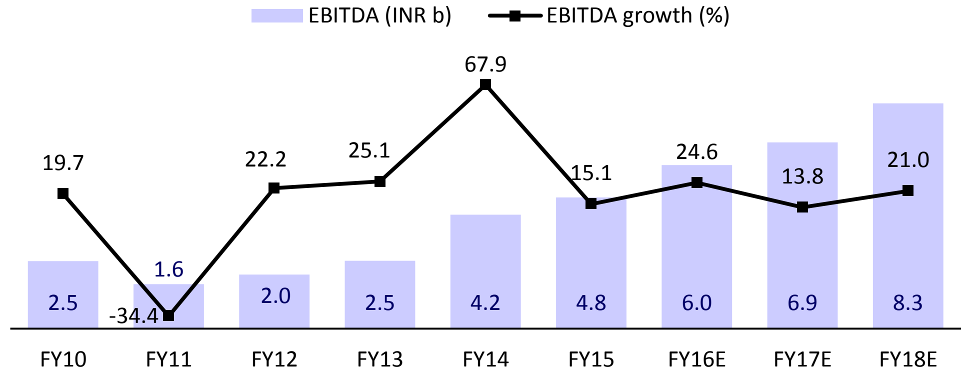
Source: Company, MOSL

Exhibit 26: Key other expenses components

Description (INR m)	FY11	FY12	FY13	FY14	FY15
Freight, transport, warehousing and distribution charges	413	667	738	810	1,070
% of Sales	4.1	5.1	4.4	4.0	4.6
Royalty	517	634	798	955	1,114
% of Sales	5.2	4.9	4.7	4.7	4.8
Business process outsourcing expenses	133	134	157	328	274
% of Sales	1.3	1.0	0.9	1.6	1.2
Professional and legal services	157	192	235	245	269
% of Sales	1.6	1.5	1.4	1.2	1.2
Distributor Coverage Expenses	195	187	249	532	739
% of Sales	1.9	1.4	1.5	2.6	3.2
Other expenses	331	443	569	481	551
% of Sales	3.3	3.4	3.4	2.3	2.4
Total-Other expenses	**1,747**	**2,257**	**2,747**	**3,351**	**4,017**
% of Sales	17.4	17.4	16.3	16.3	17.2

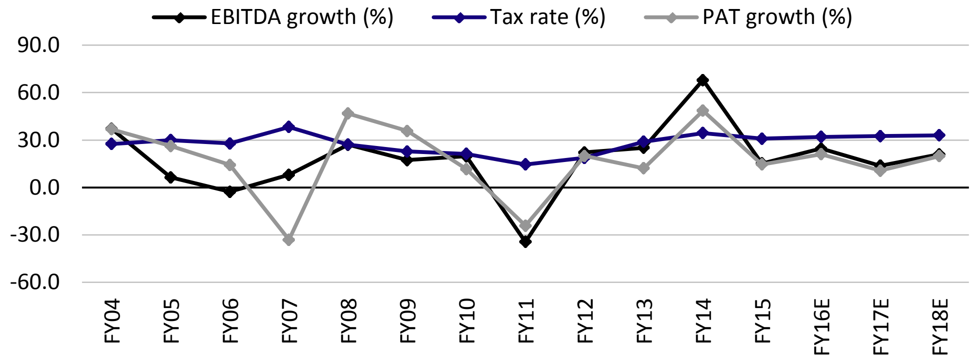
Source: Company, MOSL

Exhibit 27: YoY EBITDA margin expansion leading to stupendous EBITDA growth recently



Source: Company, MOSL

Exhibit 28: Tax rate increase was a drag on PAT growth over FY11-13



Source: Company, MOSL

The tax rate has largely peaked. While EBITDA grew by over 20% in FY12 and FY13, EPS growth was not as impressive because of a steep increase in effective tax rate from 14.6% in FY11 to 29% in FY13. This was mainly because of expiry of the 100% tax benefit at the Baddi unit, Himachal Pradesh, in FY11. Tax rate is likely to be 32% in FY16E, close to peak levels.

EBITDA grew by 34% CAGR over FY12-FY15. Going forward, while such growth is unlikely to sustain, we believe EPS growth of ~20% is possible over the medium to long term.

Cash Flows improving

Impressive Fixed asset turnover; Negative working capital

Fixed asset turnover is extremely good at ~4x and working capital cycle has been consistently negative. RoIC is also over 100%, if one strips out the cash and cash equivalents, the largest component in the balance sheet.

Exhibit 29: Negative net working capital days and healthy return ratios

Particulars	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
Inventory (Days)	22	24	21	22	22	23	21	19	17	17	17
Debtor (Days)	8	8	10	11	11	14	15	16	17	16	16
Creditor (Days)	54	52	57	62	58	50	39	47	49	49	50
Net Working Capital (Days)	-24	-19	-26	-29	-24	-13	-3	-13	-15	-16	-17
Fixed Asset t/o	3.2	3.5	3.8	3.2	3.8	4.5	4.8	4.5	4.0	3.9	4.0
RoE (%)	41.3	45.5	41.0	26.6	27.9	27.1	33.4	31.0	31.4	29.9	30.8
RoCE (%)	41.3	45.5	41.0	26.6	27.9	27.1	33.8	31.4	31.8	30.2	31.1
RoIC (%)	86.5	87.7	130.5	101.9	104.9	99.4	118.7	155.9	302.4	456.9	1035.5

Source: Company, MOSL

Lower Inter-group lending leading to improved Free Cash Flow

Net operating cash flow was healthy at INR4,256m in FY15 against INR3,352m in FY14. Free cash flow was INR3,472m versus INR1,881m in the previous year.

Growth in other assets was under control at 8% to INR7.44b. Other assets have declined from 46% of total assets in FY14 to 38%, but still remain fairly high. Lending to fellow subsidiaries was 62% of other assets in FY15 compared to 70% in FY14. In absolute terms too, this component declined from INR4,832m in FY14 to INR4,638m in FY15.

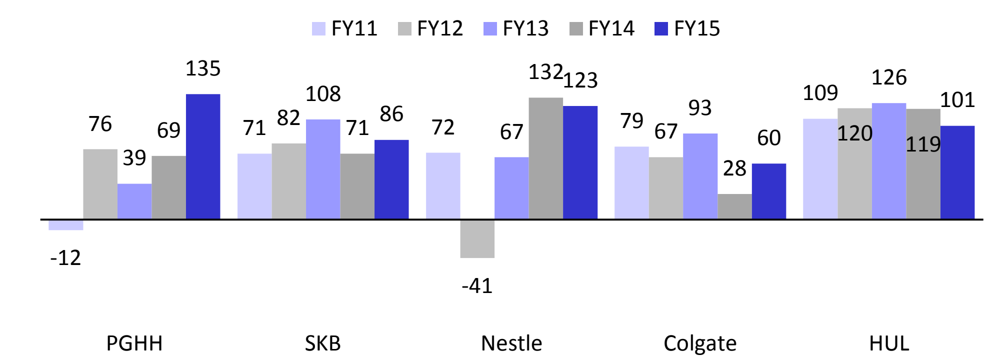
Due to healthy OCF and FCF (partly aided by decline in group lending), cash balance increased sharply from INR2,691m at the end of FY14 to INR6,186m at the end of FY15.

Exhibit 30: Break-up of cash and cash equivalents

INR m	FY10	FY11	FY12	FY13	FY14	FY15
Cash as reported	2,323	1,300	1,824	1,660	2,691	6,186
Loans to fellow subsidiaries	2,007	3,327	3,808	4,300	4,832	4,638
Cash & Cash equivalents	**4,330**	**4,627**	**5,632**	**5,960**	**7,523**	**10,824**

Source: Company, MOSL

Exhibit 31: FCF to PAT, improving, in excess of 100% and superior to MNC peers (%)



Source: Company, MOSL

Quarterly performance

Exhibit 32: Quarterly performance highlights

INR m	2QFY16	2QFY15	YoY (%)	1QFY16	QoQ (%)	1HFY16	1HFY15	YoY (%)
Total Net Sales	7,132	6,440	10.7	5,981	19.2	13,114	12,203	7.5
Other Operating Income	5	5	-2.1	4	9.3	9	7	36.4
Total Sales	**7,137**	**6,445**	**10.7**	**5,986**	**19.2**	**13,123**	**12,210**	**7.5**
Change in RM	268	88	205.9	-209	-228.7	60	-107	-155.9
Raw and Packing Material	1,398	1,617	-13.6	1,539	-9.1	2,937	3,335	-11.9
Purchase of traded goods	1,017	882	15.3	961	5.9	1,978	1,764	12.2
Employees expenses	284	227	25.1	336	-15.4	621	559	11.0
Advertising expenses	784	879	-10.7	877	-10.6	1,661	1,927	-13.8
Royalty expenses	355	316	12.4	297	19.4	652	591	10.3
Other expenses	870	1,154	-24.6	1,217	-28.5	2,087	2,069	0.8
Total Expenses	4,977	5,163	-3.6	5,018	-0.8	9,994	10,138	-1.4
EBITDA	**2,161**	**1,283**	**68.4**	**968**	**123.2**	**3,128**	**2,073**	**50.9**
Interest	23	5	400.0	12	100.0	35	16	113.0
Depreciation	142	159	-10.6	127	11.6	269	270	-0.4
Other Income	206	171	20.6	212	-2.9	418	381	9.7
PBT	**2,202**	**1,290**	**70.6**	**1,041**	**111.4**	**3,243**	**2,167**	**49.6**
Tax	735	384	91.5	344	113.8	1,078	646	67.0
PAT	**1,467**	**907**	**61.8**	**698**	**110.2**	**2,165**	**1,522**	**42.3**
PAT after Exceptionals	**1,467**	**907**	**61.8**	**698**	**110.2**	**2,165**	**1,522**	**42.3**
(%)			**Change (bp)**		**Change (bp)**			**Change (bp)**
Gross Margin	62.4	59.9	2.5	61.7	0.7	62.1	59.1	3.0
EBITDA Margin	30.3	19.9	10.4	16.2	14.1	23.8	17.0	6.9
Tax Rate	33.4	29.7	3.6	33.0	0.4	33.2	29.8	3.5
Net margin	20.6	14.1	6.5	11.7	8.9	16.5	12.5	4.0
% of Sales			**Change (bp)**		**Change (bp)**			**Change (bp)**
Raw Materials	37.6	40.1	-2.5	38.3	-0.7	37.9	40.9	-3.0
Employees expenses	4.0	3.5	0.5	5.6	-1.6	4.7	4.6	0.2
Advertising expenses	11.0	13.6	-2.6	14.7	-3.7	12.7	15.8	-3.1
Royalty expenses	5.0	4.9	0.1	5.0	0.0	5.0	4.8	0.1
Other expenses	12.2	17.9	-5.7	20.3	-8.1	15.9	16.9	-1.0

Source: Company, MOSL

Net sales higher than expected: Net sales in 2QFY16 (June year-end) rose 10.7% YoY to INR7,137m. Sales were 2.5% higher than our estimate of INR6,961m. Feminine Hygiene as well as Healthcare reportedly grew in double digits. Thus, after a blip in 1QFY16, when Healthcare reportedly declined, double-digit growth is back.

Strong performance on margin front: Gross margin expanded 250bp YoY and 70bp QoQ. We had anticipated an improvement of 314bp YoY. 2QFY16 gross margin was the highest reported for a comparable quarter since the price cuts a few years ago. Employee cost grew 25% YoY to INR284m (4% of sales for the quarter). This was 11.7% above our estimate. On the other hand, A&P as well as other expenses (including royalty) declined on an absolute basis YoY by 10.7% and 16.7%, respectively, and by 264bp and 565bp YoY, respectively, as a percentage of sales.

PGHH has not shared details on one-offs. We believe some component of the absolute decline in both these expenses may be because of one-offs. EBITDA margin expanded over 1,037bp YoY to 30.3%, a 24-quarter high. Absolute EBITDA grew 68.4% YoY to INR2,161m, 43% above our estimate. PAT also grew sharply by 61.8% YoY to INR1,467m, 37.5% above our expectation.

Balance sheet improves further: As a result of 10% YoY decline in absolute inventory and 21% YoY increase in creditors, negative net working capital increased 34% YoY. There was an improvement in negative working capital over June 2015 level as well. Another encouraging aspect about the results was the 33% YoY decline in other assets and 41% decline from June 2015 levels. The improvement came from sharp declines, both in long-term and short-term advances, which indicates that inter-group lending has declined significantly. Cash balance grew from INR4.25b at the end of December 2014 and INR6.2b at the end of June 2015 to INR10b at the end of December 2015.

Initiating coverage with Buy

Certainty on volume growth commands premium valuation

- Valuation in-line with MNC peers
- Upside risk from open offer

Valuation in-line with MNC peers; Expect 20% EPS CAGR

On an average, the stock has traded at 41x one-year forward earnings for the last three years, 38x one-year forward earnings for the last five years, and 35x one-year forward earnings for the last 8 years.

Exhibit 33: Valuation Matrix of coverage universe

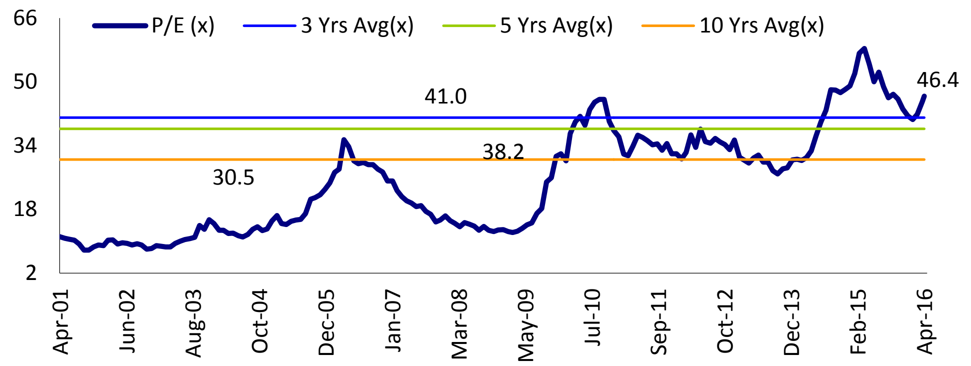
Company	Reco	Price	Mkt Cap	EPS Growth YoY (%)			P/E (x)			EV/EBITDA (x)			ROE (%)	Div. (%)
		(INR)	(USD M)	FY16E	FY17E	FY18E	FY16E	FY17E	FY18E	FY16E	FY17E	FY18E	FY16E	FY16E
Consumer														
Asian Paints	Neutral	863	12,420	27.4	13.0	9.3	45.6	40.4	37.0	31.2	27.1	24.6	35.3	1.2
Britannia	Buy	2,816	5,069	49.9	17.5	13.9	39.2	33.4	29.3	27.3	22.6	19.3	57.8	0.9
Colgate	Neutral	843	3,440	6.4	11.6	13.6	38.5	34.5	30.4	23.6	21.5	19.2	72.1	1.8
Dabur*	Neutral	267	7,044	15.0	16.2	12.5	38.2	32.9	29.2	30.6	26.1	23.2	33.0	0.9
Emami*	Buy	1,015	3,456	14.0	23.6	16.9	41.6	33.6	28.8	34.2	27.7	23.5	40.3	1.1
Godrej Consumer	Neutral	1,365	6,975	24.5	20.0	14.4	41.1	34.3	30.0	30.8	26.1	23.5	23.2	0.7
GSK Consumer	Buy	6,010	3,793	20.0	13.0	10.7	36.1	31.9	28.9	25.6	22.4	19.6	30.5	1.1
Hind. Unilever	Neutral	884	28,688	5.0	10.9	14.2	48.1	43.4	38.0	33.2	30.4	26.8	110.3	1.9
ITC	Buy	321	38,718	2.7	13.1	14.0	26.1	23.0	20.2	17.0	15.2	13.5	30.4	2.5
Jyothy Labs	Buy	300	816	26.4	-8.7	12.6	33.8	37.0	32.9	27.9	23.5	20.8	19.6	1.3
Marico*	Neutral	254	4,921	24.8	15.8	12.4	45.8	39.6	35.2	30.8	26.3	23.2	35.2	0.8
Nestle	Neutral	5,889	8,522	-7.3	-10.7	18.4	49.1	55.0	46.5	34.5	31.2	26.0	40.9	0.8
Page Industries	Buy	12,755	2,135	21.0	25.0	31.3	60.0	48.0	36.5	37.5	30.4	23.5	46.9	0.7
PGHH	Buy	6,402	3,174	21.0	10.6	19.9	49.7	44.9	37.4	32.8	28.4	23.2	31.4	1.0
Pidilite Inds.	Buy	603	4,640	48.5	10.2	15.1	40.5	36.8	32.0	25.4	22.3	19.3	29.8	0.7
Radico Khaitan	Buy	92	182	-3.0	31.5	28.9	14.2	10.8	8.4	9.6	7.9	6.5	9.5	1.1
United Spirits	Buy	2,439	5,319	LP	76.9	46.6	84.9	48.0	32.7	39.7	28.6	21.4	48.1	0.0

Note: For Nestle FY15 means CY14 Source: Company, MOSL

Current P/E multiples are in line with Consumer MNC peers (Adjusted for its high non-operating income GSK Consumer's PE is higher than what is stated above) despite PGHH's distinct advantages of (1) being in a much faster growing category, and (2) enjoying far superior barriers to entry in its key Feminine Hygiene segment. Its ongoing distribution expansion and unmatched category development efforts will only enhance the entry barriers. PGHH could compound its revenues manifold by gaining share in an ever increasing pie.

PGHH's earnings growth prospects in the near term, medium term and long term are superior to peers. We expect ~20% EPS CAGR over the medium to long term. Balance sheet is healthy, with negative working capital and RoE/RoCE of over 30% and RoIC of over 100%. These metrics call for a significant premium to peer valuations. We assign a target multiple of 45x FY18E EPS to the company, a 10% premium to the average one-year forward multiple of the last three years. Our target price of INR7,690 implies 20% upside.

Exhibit 34: One-year forward P/E



Source: Company, MOSL

Possible open offer to PGHH shareholders by parent company an upside risk

P&G owns 70.64% stake in PGHH and might make an open offer to PGHH's shareholders. India is a key growth area for the parent and salience of the Feminine Hygiene segment in global sales is also increasing rapidly. While the potential open offer is not one of our core investment arguments, it is a possibility. The open offer price will have to be at substantial premium to the prevailing market price. In the two recent open offers in the Consumer space, GlaxoSmithKline Consumer Healthcare and HUVR paid 28% and 20% premium, respectively, to their then prevailing market prices.

BULL & BEAR Case

Bull Case

- Our bull case assumptions have positive impact on operating margins and lower capex assumptions for FY17E and FY18E.
- Instead of assuming a decline in gross margins over FY16E in the base case, we are assuming 20 bps YoY improvement each for FY17E and FY18E.
- In the base case we are expecting over 150 bps increase in A&P in FY17E and FY18E over FY16E levels. In the bull case we are assuming flat A&P to sales at 16% of sales, similar to FY16E, still higher than FY15 levels.
- Instead of assuming Capex of ~INR1.6 b each for FY17E and FY18E, we are only assuming capex of ~INR750m each for both years largely in line with the capex of the preceding few years
- There is no change to our FY16E EPS on the bull or bear case but there is an increase of 9.8% in FY17E EPS and 11.8% in FY18E EPS over the base case EPS to INR155.9 and INR191.1 respectively
- Assuming the same 45x target multiple that we have taken for the base case, we get a bull case target price of INR8,595 (upside of 34% to CMP) based on FY18 EPS instead of the base case target price of INR7,690, upside of 20%

Exhibit 35: Bull case

	FY15	FY16E	FY17E	FY18E
Sales (INR m)	**23,338**	**25,648**	**29,847**	**35,921**
Sales growth (%)		9.9	16.4	20.4
EBITDA (INR m)	**4,844**	**6,053**	**7,402**	**9,088**
EBITDA Margin (%)	20.76	23.6	24.8	25.3
EBITDA Growth (%)		25.0	22.3	22.8
PAT (INR m)	**3,461**	**4,201**	**5,065**	**6,207**
PAT Margin (%)	14.83	16.38	16.97	17.28
PAT Growth (%)		21.4	20.6	22.5
EPS (INR)	**106.5**	**129.3**	**155.8**	**191.0**
Target multiple (x)				45
Target Price (INR)				8,595
Upside/downside (%)				34.2

Bear Case

- Our bear case assumptions mainly have a negative impact on both sales growth operating margins for FY17E and FY18E.
- We are assuming a marginal decline in gross margins in FY17E and FY18E in the base case. In the bear case assume an 80 bps decline between FY16E-FY18E
- In our bear case, other expenses to sales are also expected to increase over FY16E levels as sales growth going forward will be moderate
- There is no change in FY16 EPS on the bull or bear case but there is a decrease of of 11.3% in FY17E EPS and 19.8% decrease in FY18E EPS over the base case to INR125.9 and INR137.1 respectively.
- Assuming the same 45x target multiple that we have taken for the base case, we get a bear case target price of INR6,167 (downside of 3.7% to CMP) based on FY18 EPS instead of the base case target price of INR7,690, upside of 20%.

Exhibit 36: Bear Case

	FY15	FY16E	FY17E	FY18E
Sales (INR m)	**23,338**	**25,574**	**28,333**	**32,040**
Sales growth (%)		9.6	10.8	13.1
EBITDA (INR m)	**4,844**	**6,035**	**6,063**	**6,664**
EBITDA Margin (%)	20.76	23.6	21.4	20.8
EBITDA Growth (%)		24.6	0.5	9.9
PAT (INR m)	**3,461**	**4,189**	**4,094**	**4,454**
PAT Margin (%)	14.83	16.38	14.45	13.90
PAT Growth (%)		21.0	-2.3	8.8
EPS (INR)	**106.5**	**128.9**	**126.0**	**137.0**
Target multiple (x)				45
Target Price (INR)				6,167
Upside/(downside) (%)				-3.7

Risks and concerns

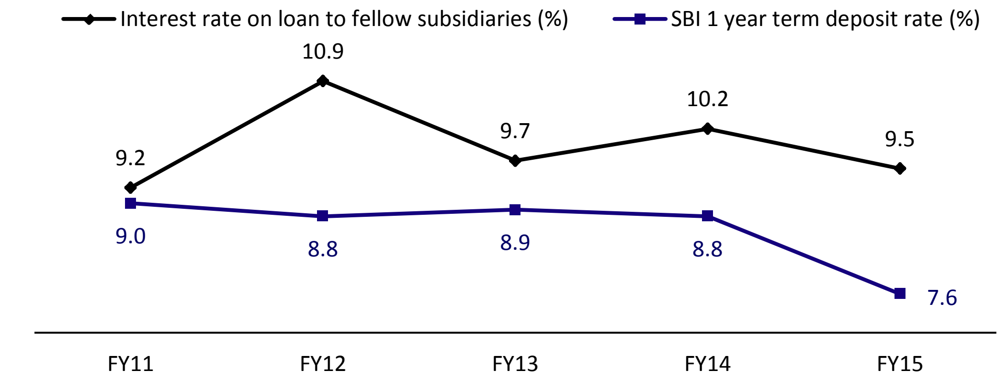
- **Change in strategy**

If PGHH decides to raise prices sharply in the Feminine Hygiene segment, it would adversely impact affordability and volume growth potential. Having chosen to cut prices and absorb the pain on the EPS growth front to achieve volume growth, we believe the company is unlikely strive for profitability at the cost of volume growth.

- **Lending to subsidiaries**

This is admittedly a poor corporate governance practice, but PGHH has been sharing interest earned on these loans separately. These earnings are better than the prevalent term-deposit rates. If the disclosure regarding interest income on lending to subsidiaries is stopped, or it earns below term-deposit rates, there could be a stock de-rating. Encouragingly, intra-group lending as a percentage of total cash and cash equivalents is declining, albeit off a large base. It was, in fact, down sharply even in absolute terms in FY15 as well as 1HFY16.

Exhibit 37: Interest earned versus term deposit rates



Source: Company, MOSL

Even considering that SBI's 1 year deposit rate is usually at a 50 bps discount to peers, the gap between the prevalent deposit rate and the yield that the company gets is comfortably large.

According the revised company guidelines of P&GHH, all related party transactions are placed before the Audit Committee for review and approval. Prior omnibus approval is obtained for related party transactions that are repetitive in nature and entered in the ordinary course of business and at arm's length. All related party transactions are subjected to independent review by external chartered accountancy firm to confirm compliance with the requirements under Companies Act 2013 and the Listing Agreement.

- **Launch of Pampers diapers through unlisted entity**

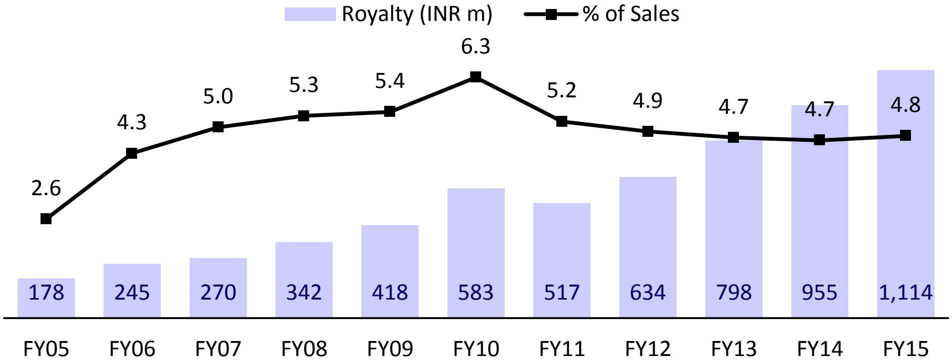
It was widely anticipated that *Pampers* diapers would be launched in India through PGHH, as the business is an obvious fit with the company's Feminine Hygiene segment in terms of manufacturing and distribution. However, the parent chose to launch *Pampers* diapers in India through its unlisted entity, P&G Home Products.

Our optimism on PGHH's prospects is because of the huge growth potential in the Feminine Hygiene segment and not due to the possibility of P&G launching new products in India through PGHH.

- **Possible increase in royalty**

Royalty has reduced from over 5% of sales over FY07-11 to 4.8% in FY15. Any sharp increase in the royalty rate could affect future profitability.

Exhibit 38: Royalty as a percentage of sales declined in recent years

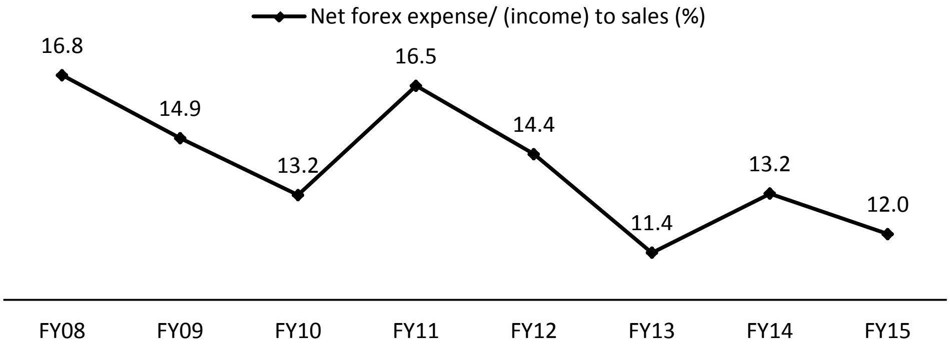


Source: Company, MOSL

- **Steep rupee depreciation**

PGHH's forex expenses to sales (including imports) stood at 12.4% in FY15. Forex income, on the other hand, is just 0.4% of sales, leading to net forex expenses at 12% of sales for the year. While the net forex expenses-to-sales ratio is declining over the past few years, steep rupee depreciation could have an impact on operating margin, going forward. Raw material imports (likely to be cellulose) account for the largest share in total forex expenses.

Exhibit 39: Forex expenses to sales



Source: Company, MOSL

- **Declining dividend payout**

In FY15, the general improvements all round in the balance sheet were negated by lower dividend payout, which led to a build-up of cash balance and marginally lower RoE and RoCE. While RoE and RoCE were still healthy at 31% in FY15, these were lower than the 33% and 34% in FY14. RoIC, however, improved from already impressive levels of 136% in FY14 to 182% in FY15. With huge growth in cash in

1HFY16 and sharp decrease in group lending, we expect payout to increase to over 40% levels.

Exhibit 40: Dividend payout declined in past two years

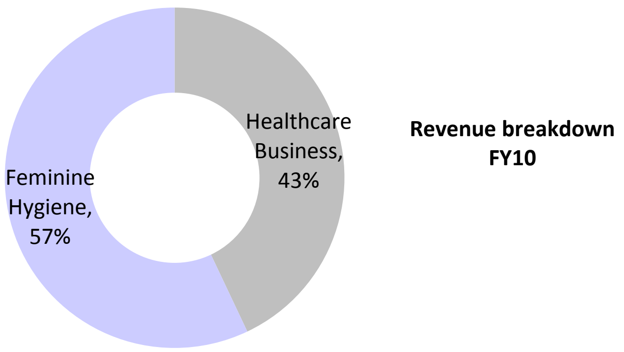
Particulars	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
Inventory (Days)	22	24	21	22	22	23	21	19
Debtor (Days)	8	8	10	11	11	14	15	16
Creditor (Days)	54	52	57	62	58	50	39	47
Fixed Asset t/o	1.8	1.7	1.7	1.7	1.9	2.1	2.1	1.9
RoE (%)	41.3	45.5	41.0	26.6	27.9	27.1	33.4	31.0
RoCE (%)	41.3	45.5	41.0	26.6	27.9	27.1	33.8	31.4
RoIC (%)	86.5	87.7	130.5	101.9	104.9	99.4	118.7	155.9
Payout (%)	**57.6**	**47.8**	**42.7**	**56.1**	**46.8**	**46.7**	**34.6**	**34.1**

Source: Company, MOSL

Company background

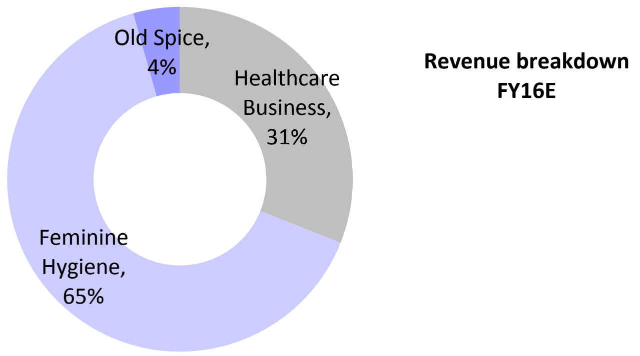
Procter & Gamble Hygiene & Health Care Limited (PGHH), a 71% subsidiary of P&G, manufactures, distributes and markets three major brands in India – *Whisper* (sanitary napkins), *Vicks* (balm, cough drops and tablets), and *Old Spice* (aftershave lotion and deodorants). *Whisper* is the market leader, with ~56% share in the INR30.2b (FY16E) Indian Feminine Hygiene market, and is likely to contribute ~65% of sales in FY16 (June year-end). *Vicks* is also the market leader, with over 30% share in the INR25.5b (FY16E) Cough, Cold and Hay Fever segment of OTC (over the counter) products, and is expected to contribute ~31% of PGHH's FY16 sales. The *Old Spice* range, which had been out-licensed until March 2013, is now a part of PG's sales, but its share is expected to be small at ~4% of the company's sales in FY16.

Exhibit 41: Revenue breakdown as of FY10



Source: Company, MOSL

Exhibit 42: Revenue breakdown as of FY16E



Source: Company, MOSL

History in India

Vicks Product India was set up in 1951 as a subsidiary of Vicks Inc, USA. In 1964, a public limited company called Richardson Hindustan was formed, which obtained an industrial license to manufacture menthol and de-mentholized peppermint oil and the *Vicks* range of products such as *Vicks Vaporub*, *Vicks Cough Drops* and *Vicks Inhaler*. When P&G acquired *Vicks* globally in 1985, this entity became its subsidiary. In 1989, the name of the company was changed to P&G India and the company launched *Whisper* sanitary napkins. In 1999, the company's name was changed again to P&G Hygiene and Health Care. The company manufactures its range of products at its plants in Goa and Himachal Pradesh.

The listed P&G Hygiene and Health Care is one of three P&G entities in India, the others being P&G Home Products (unlisted) and Gillette India (listed; 75% owned by the parent).

Management Background

From August 28, 2015, Mr Al Rajwani is the new managing director (MD) of the company. Mr Rajwani is a P&G veteran of nearly 35 years, who has worked in various roles globally – product supply, marketing and general management in USA, Canada, China, Korea and the Arabian Peninsula. His last job prior to joining the India operations was as General Manager/Vice President of P&G's Arabian Peninsula and Pakistan operations. He was responsible for developing P&G's extensive portfolio of brands in Saudi Arabia, the Gulf, Yemen and Pakistan. In addition to his brand building responsibilities, he oversaw all functional and personnel matters in these countries.

Mr Kartik Natarajan, CFO has been with P&G for over 15 years. Prior to this role, he has worked across multiple locations including US, China, Philippines and Singapore. He has held global responsibilities and has led strategy development, business & financial planning and operational execution with excellence for several important P&G businesses over his tenure with P&G.

Mr Rajwani and Mr Natarajan are also MD and CFO of P&G's other two entities in India, P&G Home Products and Gillette India.

Financials and Valuations

Standalone - Income Statement (INR Million)

Y/E June	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
Income from Operations	10,400	13,038	16,986	20,673	23,599	26,230	30,831	36,981
Less: Excise Duty	368	64	118	164	261	655	1,233	1,479
Total Income from Oper.	**10,032**	**12,974**	**16,868**	**20,509**	**23,338**	**25,574**	**29,598**	**35,503**
Change (%)	8.5	29.3	30.0	21.6	13.8	9.6	15.7	19.9
Raw Materials	3,896	5,243	7,045	8,128	9,209	9,565	11,010	13,172
% of Sales	38.8	40.4	41.8	39.6	39.5	37.4	37.2	37.1
Employees Cost	506	647	997	950	1,133	1,304	1,332	1,633
% of Sales	5.0	5.0	5.9	4.6	4.9	5.1	4.5	4.6
Other Expenses	3,992	5,083	6,321	7,225	8,152	8,670	10,389	12,390
% of Sales	39.8	39.2	37.5	35.2	34.9	33.9	35.1	34.9
Total Expenditure	**8,394**	**10,972**	**14,362**	**16,303**	**18,494**	**19,539**	**22,731**	**27,195**
% of Sales	83.7	84.6	85.1	79.5	79.2	76.4	76.8	76.6
EBITDA	**1,639**	**2,002**	**2,506**	**4,207**	**4,844**	**6,036**	**6,867**	**8,308**
Margin (%)	16.3	15.4	14.9	20.5	20.8	23.6	23.2	23.4
Depreciation	222	281	313	352	525	622	744	866
EBIT	**1,417**	**1,721**	**2,192**	**3,855**	**4,319**	**5,413**	**6,122**	**7,441**
Int. and Finance Charges	0	0	0	54	57	62	77	86
Other Income	354	509	670	802	746	810	822	937
PBT bef. EO Exp.	**1,771**	**2,230**	**2,862**	**4,603**	**5,008**	**6,161**	**6,868**	**8,292**
PBT after EO Exp.	**1,771**	**2,230**	**2,862**	**4,603**	**5,008**	**6,161**	**6,868**	**8,292**
Total Tax	259	417	830	1,583	1,547	1,972	2,232	2,737
Tax Rate (%)	14.6	18.7	29.0	34.4	30.9	32.0	32.5	33.0
Reported PAT	**1,512**	**1,813**	**2,032**	**3,020**	**3,461**	**4,190**	**4,636**	**5,556**
Adjusted PAT	**1,512**	**1,813**	**2,032**	**3,020**	**3,461**	**4,190**	**4,636**	**5,556**
Change (%)	-24.2	19.9	12.1	48.6	14.6	21.0	10.6	19.9
Margin (%)	15.1	14.0	12.0	14.7	14.8	16.4	15.7	15.6

Standalone - Balance Sheet (INR Million)

Y/E June	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
Equity Share Capital	325	325	325	325	325	325	325	325
Total Reserves	5,682	6,646	7,729	9,704	11,962	14,034	16,326	19,074
Net Worth	**6,006**	**6,970**	**8,053**	**10,029**	**12,287**	**14,359**	**16,651**	**19,398**
Deferred Tax Liabilities	28	-15	-30	-72	-40	-44	-48	-53
Capital Employed	**6,034**	**6,955**	**8,024**	**9,957**	**12,247**	**14,315**	**16,603**	**19,346**
Gross Block	3,129	3,459	3,775	4,281	5,237	6,444	7,592	8,804
Less: Accum. Deprn.	1,225	1,475	1,626	1,886	2,149	2,771	3,515	4,382
Net Fixed Assets	**1,904**	**1,984**	**2,149**	**2,395**	**3,088**	**3,673**	**4,077**	**4,423**
Capital WIP	76	289	412	982	390	382	434	422
Curr. Assets, Loans&Adv.	**6,797**	**8,697**	**9,903**	**11,631**	**15,960**	**18,264**	**21,105**	**25,138**
Inventory	653	923	1,189	1,185	1,191	1,191	1,379	1,654
Account Receivables	310	482	809	861	1,139	1,191	1,297	1,556
Cash and Bank Balance	1,300	1,824	1,660	2,691	6,186	10,134	12,678	15,422
Loans and Advances	4,534	5,469	6,245	6,894	7,444	5,747	5,751	6,506
Curr. Liability & Prov.	**2,742**	**4,015**	**4,440**	**5,050**	**7,190**	**8,004**	**9,013**	**10,636**
Account Payables	1,828	3,097	2,895	2,934	4,570	4,380	5,013	6,006
Provisions	915	918	1,545	2,117	2,621	3,624	4,000	4,631
Net Current Assets	**4,054**	**4,682**	**5,463**	**6,581**	**8,770**	**10,260**	**12,092**	**14,501**
Appl. of Funds	**6,034**	**6,955**	**8,024**	**9,957**	**12,247**	**14,315**	**16,603**	**19,346**

E: MOSL Estimates

Financials and Valuations

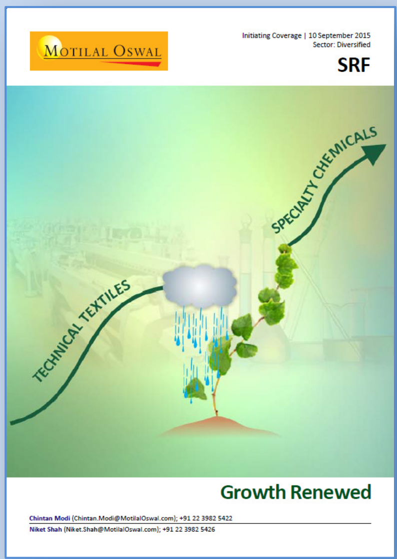
Ratios								
Y/E June	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16E**	**FY17E**	**FY18E**
Basic (INR)								
EPS	**46.6**	**55.8**	**62.5**	**92.9**	**106.5**	**128.9**	**142.6**	**171.0**
Cash EPS	53.4	64.5	72.3	103.9	122.8	148.2	165.7	197.9
BV/Share	185.0	214.7	248.1	309.0	378.5	442.3	513.0	597.6
DPS (incl tax)	26.1	26.1	29.2	32.2	36.4	65.2	72.2	86.5
Payout (%)	56.1	46.8	46.7	34.6	34.1	50.6	50.6	50.6
Valuation (x)								
P/E				68.9	60.1	49.7	44.9	37.4
Cash P/E				61.6	52.1	43.2	38.6	32.4
P/BV				20.7	16.9	14.5	12.5	10.7
EV/Sales				10.0	8.6	7.7	6.6	5.4
EV/EBITDA				48.8	41.6	32.8	28.4	23.2
Dividend Yield (%)	0.4	0.4	0.5	0.5	0.6	1.0	1.1	1.4
FCF per share	-5.4	42.3	24.2	63.9	144.1	186.9	150.6	171.1
Return Ratios (%)								
RoE	26.6	27.9	27.1	33.4	31.0	31.4	29.9	30.8
RoCE	26.6	27.9	27.1	33.8	31.4	31.8	30.2	31.1
Working Capital Ratios								
Asset Turnover (x)	1.7	1.9	2.1	2.1	1.9	1.8	1.8	1.8
Inventory (Days)	22	22	23	21	19	17	17	17
Debtor (Days)	11	11	14	15	16	17	16	16
Creditor (Days)	62	58	50	39	47	49	49	50
Leverage Ratio (x)								
Debt/Equity	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Standalone - Cash Flow Statement								(INR Million)
Y/E June	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16E**	**FY17E**	**FY18E**
Reported profit after tax	1,512	1,813	2,032	3,020	3,461	4,190	4,636	5,556
Depreciation	99	250	151	260	263	622	744	866
Provisions	5	3	627	571	504	1,003	376	631
Deferred Taxes	6	-43	-14	-42	32	-4	-4	-5
(Inc)/Dec in WC	-1,683	-107	-1,571	-659	802	1,455	336	-296
CF from Operations	**-60**	**1,916**	**1,225**	**3,150**	**5,063**	**7,266**	**6,087**	**6,753**
Others	-3	0	0	0	-22	0	0	0
CF from Operating incl EO	**-64**	**1,916**	**1,225**	**3,150**	**5,041**	**7,266**	**6,087**	**6,753**
(Inc)/Dec in FA	-111	-543	-439	-1,075	-364	-1,200	-1,200	-1,200
Free Cash Flow	**-175**	**1,373**	**786**	**2,075**	**4,677**	**6,066**	**4,887**	**5,553**
(Pur)/Sale of Investments	0	0	0	0	0	0	0	0
Others	0	0	0	0	0	0	0	0
CF from Investments	**-111**	**-543**	**-439**	**-1,075**	**-364**	**-1,200**	**-1,200**	**-1,200**
Issue of Shares	0	0	0	0	0	0	0	0
Inc/(Dec) in Debt	0	0	0	0	0	0	0	0
Dividend Paid	-849	-849	-949	-1,044	-1,182	-2,118	-2,343	-2,809
Others	0	0	0	0	0	0	0	0
CF from Fin. Activity	**-849**	**-849**	**-949**	**-1,044**	**-1,182**	**-2,118**	**-2,343**	**-2,809**
Inc/Dec of Cash	**-1,024**	**524**	**-163**	**1,031**	**3,495**	**3,948**	**2,544**	**2,744**
Opening Balance	2,324	1,300	1,824	1,661	2,691	6,186	10,135	12,679
Closing Balance	**1,300**	**1,824**	**1,661**	**2,691**	**6,186**	**10,134**	**12,678**	**15,422**

NOTES

REPORT GALLERY

RECENT INITIATING COVERAGE REPORTS



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